

Notre Europe European Steering Committee

7-8 November 2008

Proposition

The European Union's acid test

by Tommaso Padoa-Schioppa¹
President of *Notre Europe*

*"In order to hide the redness of their foreheads,
the actors called on stage put on a mask.
Like them, when appearing in the theatre of the world,
where until now I have only been a spectator, I go masked."
René DESCARTES, "Preamble", Oeuvres Philosophiques,
t. I, F Alquié, Paris, Garnier, 1963, p 45*

TOMMASO PADOA-SCHIOPPA GRADUATED FROM THE LUIGI BOCCONI UNIVERSITY, MILAN, ITALY, IN 1966 AND IS HOLDER OF A MASTER OF SCIENCE FROM THE MASSACHUSETTS INSTITUTE OF TECHNOLOGY. HE IS CAVALIERE DI GRAN CROCE DELLA REPUBBLICA D'ITALIA. HIS PAST FUNCTIONS INCLUDE: JOINT SECRETARY TO THE DELORS COMMITTEE FOR THE STUDY OF EUROPEAN ECONOMIC AND MONETARY UNION (1988 - 1989); CHAIRMAN OF THE BANKING ADVISORY COMMITTEE OF THE COMMISSION OF THE EUROPEAN COMMUNITIES (1988 - 1991); OF THE WORKING GROUP ON PAYMENT SYSTEMS OF THE CENTRAL BANKS OF THE EUROPEAN COMMUNITY (EUROPEAN MONETARY INSTITUTE) (1991 - 1995); OF THE BASLE COMMITTEE ON BANKING SUPERVISION (1993 - 1997); OF THE EUROPEAN REGIONAL COMMITTEE OF IOSCO, WHICH COMPRISES THIRTY-FOUR COUNTRIES (1997 - 1998); OF THE FESCO (FORUM OF THE EUROPEAN SECURITIES COMMISSIONS) (1997 - 1998); AND OF THE G10 COMMITTEE ON PAYMENTS AND SETTLEMENT SYSTEMS (2000 - 2005) AND FORMER MINISTER OF ECONOMY IN THE ITALIAN GOVERNMENT (2006-2008).

HE IS PRESIDENT OF *NOTRE EUROPE* SINCE 2005.

¹ I would like to thank Gaëtane Ricard-Nihoul, Pierre Lepetit, as well as Jacques Delors and several members of Notre Europe's Board of Directors for giving me their contributions and suggestions for the preparation of this text for which I take all responsibility.

1. Europe facing the need for global governance

When it rose to become an actor on the world stage, Europe did not say openly what it was doing; but the time for allusions is now past. Descartes's formulation only refers to a fleeting state: the mask represents a phase of searching for the truth. Today we must proclaim and put into practice this truth.

The challenges of globalisation and of the quest for a new world order lie before us. The many problems in the world which appeared or worsened in 2008 are symptoms of a lack, which threatens prosperity, peace and even life on earth. What is lacking is the capacity to govern, democratically, a world which is quickly becoming one. Peace and international stability can be built neither on the hegemony of a superpower nor on the hazardous game of the balance of power. The lesson of history is that the race not to be on the wrong side of the balance of power has always been a costly one and has always ended in conflict. The effort to govern cannot succeed if public action has an excessively narrow horizon in time and space. As for the economy, it is true that lasting prosperity and a vanquishing of poverty

cannot be achieved without free trade and capital movement; but it is equally true that the power of world markets becomes dangerous if not disciplined by rules.

The point of history and the imminent political changes in the United States and the European Union make 2009 a risky year for the future of the world but also create an opportunity – especially for Europe. The financial crisis, the Doha Round impasse and the slowing of international growth are opening a new phase for the world economy, and giving increased responsibility to those who govern it. The Georgian crisis revealed, suddenly, the urgent need to create lasting stability in Eurasia.

The Obama Presidency will open a new chapter in the Euro- American relationships. The new Administration will be obliged to carry out a profound revision of the directions taken during the eight years of the Bush Presidency; it will have to deal with its negative economic and strategic legacy; it will probably interpret the American leadership with a spirit of innovation and a capacity of persuasion which have been lacking for long and which will put it back at the centre of the global scene. If it will itself prove capable of change and progress, Europe will perhaps find an open minded partner; a floppy and undecided Europe will rest on its role of secondary ally.

For the European Union, the different problems of the moment come together into a single major challenge – that of being an actor and not simply a spectator on the world's theatre stage. Since years we have seen how Europe can overcome its difficulties when it exists and how much these difficulties are exacerbated when it is divided. The European Union can give the decisive spur for a new world governance, since the EU is itself built on the principles appropriate to this challenge. These principles are multilateralism, pooled sovereignty and democratic responsibility. It is therefore necessary that the Union apply these principles to itself with

more decisiveness and more coherence. In order to gain control of today's events instead of being their victim, the EU must break with certain taboos and give itself a capacity for decision and action which is on a par with the Union's declared responsibilities and ambitions.

The European agenda of 2009 is set against this backdrop. Two of the main European institutions – the Parliament and the Commission – will be renewed, respectively in June and November 2009. The EU is set for a re-examination of its policies and finances in order to lay the basis of its new budget priorities for 2014-20. With its 27 members, the EU will have to demonstrate its capacity for decision and action in the face of internal and external challenges. It must do this openly, creating a stronger bond with the peoples it is helping to bring together. With the Treaty of Lisbon or *a fortiori* without it, the member states must accept a sharing of sovereignty.

2. Four fronts, one challenge

The challenge of the moment has *four main fronts*: security, the economy, democracy, the environment. Europe will be able to rise to this challenge – for its own good and for the good of the world – if *two fundamental conditions* are met: a genuine capacity for decision and an efficient use of its resources.

2.1 Security: building a continental order

History is cruel to those who arrive late. The August crisis between Russia and Georgia is an example. In the first place, of course, this was the result of long-brewing local tensions and of inopportune acts by the two governments concerned; and the EU showed itself capable of a quick and coordinated response. But this crisis is equally the consequence of the ambivalence and the sluggishness of Europe (and the rest of the West) in building a new continental order of peace and cooperation after the collapse of the Soviet empire and end of the Cold War. Despite forty years of 'European construction', the incomplete nature of the project left the

EU poorly equipped to meet challenges on its borders. Because of this, the Union was incapable of giving full support to the creation of a just and stable order on 'its' continent – support that the EU could have given and that the EU needed for its own security.

The enormous job of institution-building which led to the enlargement of 2004 was carried out efficiently and professionally by the Union. But the slowness and drudgery of this work disappointed the hopes for a quick accession by public opinion and political elites in central Europe. Furthermore, the absence of a genuine common foreign and defence policy prevented the Union from responding to the pressing security needs of countries which still felt threatened by Russia. As for Russia – which experienced the collapse not only of the empire built by Stalin but also of a greater Russia established over centuries – a seemingly open-ended process of enlargement of both the EU's and NATO's frontiers could only be perceived as a threat.

The 2008 war in Georgia showed up this lateness relative to the clock of history and brought to light two inadequacies of a foreign policy based on the enlargement model.

Firstly, on a regional level, the Georgian war and the Union's inability to prevent it demonstrated the weakness of the EU's position in the southern Caucasus. The European Neighbourhood Policy, designed both as an alternative to enlargement and as a way to put to use the political capital gained in the membership process, turned out to be neither of these things. For the eastern neighbours, the policy is not seen as an attractive alternative to membership, precisely because it has been a replica of the membership process but without the final reward. The policy has indeed neglected the importance of conditionality – which it lacked – in the success of past enlargements. Only a Neighbourhood Policy freed of the straitjacket of the

enlargement model will be able to acquire its own stature and make the Union a credible political actor in the region.

The second issue is global in scope and concerns the interaction between the Union and the other world powers, Russia and the United States in particular. Not having perfected an effective alternative to its enlargement, the Union has wavered between inaction and clumsiness. Passivity vis-à-vis the United States in cases such as the Middle East, or vis-à-vis Russia in the case of Georgia – the Union proclaimed its objectives but did not give itself the means to meet them, and was left to look on powerlessly as other powers made the rules. Clumsiness when it has attempted to assert itself strategically vis-à-vis the other powers. In its relations with Russia, for example, Europe has not clearly understood how much that country has felt threatened by an EU and NATO enlargement process conducted without proper consultation aimed at establishing a framework for peace and security based on mutual commitments.

The Copenhagen criteria, laid down in 1993, are no longer sufficient as guidelines for enlarging the borders as they are in 2008. New criteria should take account of the need for a strong and effective Europe and the risks of institutional instability and geopolitical tensions. More fundamentally, we should ask whether the moment has arrived for the Union – aiming at building a peaceful and prosperous order on 'its' continent - to work towards defining clearly two points which constitute the principal elements of any foreign policy. The points are the question of 'final' borders (which the Turkish issue makes particularly delicate and which some think should remain in a state of ambiguity), and that of a defence guarantee to any member state whose security is threatened. The resulting continental order would not be solid without active commitment on the part of Russia, based on an agreement between it and the Union.

2.2 The economy: from single currency to economic union

The current world economic crisis is the most serious of any since the Second World War. At its roots are the rising American foreign debt; an inadequately governed globalisation; the illusion that the markets in general and the financial system in particular are able to self-regulate; the absence of an international monetary regime; and the poor adaptation to the rise of new economic powers in Asia. At this point it is impossible to predict the duration and the outcome of the profound change happening before our eyes.

Even if it bears less responsibility than other regions of the world in the underlying causes of the crisis, Europe is not sheltered from the storm. It will emerge either strengthened or undermined by internal conflict. As is often the case, adversity is at once an opportunity and a threat.

The Union has advantages which make it better placed than others to confront the deteriorating economic climate. Its macro-economic good health, to start with: an external balance sheet in the black, reduced deficits and public debt, inflation under control. Second, the EU's more balanced idea of the roles of the market and the state in making the economic and financial system functioning. Thirdly, its social protection regime (health, pensions, unemployment benefit), whose structure and tools can mitigate the effects of financial disorder and economic slowdown.

However, the Union has also weaknesses and vulnerabilities, not shared by other world actors (the United States, China and Japan, for example). Most importantly, it is inadequately endowed with the powers and instruments which are indispensable to manage a crisis effectively; in large part these are still in the hands of the 27 member states. Despite its advantages, Europe thus faces a much more substantial risk than the one faced by the US: that of a disintegration of the great internal market built step by step

over fifty years. The prolongation of a crisis of confidence might paralyse not only the financial sector but also the economy and have, in the end, political repercussions.

Particularly in the financial sector, where it benefits from the single currency, the Union lacks two crucial tools: prudential control and governmental action. National responses using these tools in fragmented and non-uniform ways are more likely to trigger conflict and fear than to restore confidence. Some worrying signs of this are already visible in such areas as deposit insurance, the injection of public funds into banks and restrictions on financial transactions. The financial supervision has to become one of the EU's competences.

More generally, the Economic and Monetary Union must become a genuine economic union. The response to a crisis which is not simply financial can only be a mix of measures – temporary but powerful – which aim to protect and to support: *protection* of savings, of the capital of financial institutions, of jobs and businesses; and *support* for the economy by means of public investment. If however the response takes the form of dispersed actions governed by the 'each for himself' principle, the protection will become protectionism and the support will result in unmanageable distortions of competition. The very foundations on which Europe built its strength and success will have been undermined. It is important not to forget that the remarkable increase in wellbeing in all the states that have joined the EU over the years is a product of the great internal market, founded – in Jacques Delors's words – on 'competition that stimulates, cooperation that strengthens and solidarity that unites'. If the political response to a systemic challenge is not itself systemic, its chances of success will be dim. Only a more united Union with genuine crisis powers (which the original treaties reserved for member states in the form of safeguard clauses) will be able to confront the successive panics in the markets and any sudden drop in economic activity.

What is true for the EU internally is true – and more so – for the contribution that the EU, and the EU alone, can make to the remodelling of the world economic order, demanded today by experts and even governments. The European Union is founded on the acceptance and implementation of a simple principle: the creation and effective functioning of an integrated internal market – be it continental or global – are only possible under the authority of rules and powers placed above the market actors, businesses or local public authorities. It is because this principle has been applied only minimally to globalisation that globalisation has advanced in an unbalanced and uncontrolled way. Only the European Union has been able to create the toolset necessary for governing internationalisation. Because the Union has adopted this principle – even if only partially – as the basis of its own regional integration process, it has the right and the credibility to demand to be applied at the international level.

However, the precondition for such a demand to be both effective and legitimate is that the EU completes building its EMU by strengthening the economic component, which must be founded on a capacity to decide and to act both internally and externally. The debate is not new. Today it must move beyond the semantic dispute about the “economic government”. The independence of the European Central Bank is non-negotiable and will emerge from this turmoil strengthened. This financial crisis demonstrates that coordinated action by member-state governments on economic policy is indispensable and not to the detriment of the ECB. But economic governance has its own agenda and goes beyond meetings of Heads of States and Governments. It is time for this subject to be considered in depth, possibly by an instance similar to the ‘Delors Committee’ of 1988, which would deal with economic, fiscal and social dimensions of the EMU.

2.3 Democracy: Public opinion which is both free and involved

In 1998 the European Steering Committee of Notre Europe discussed and approved a text containing this passage: ‘A significant transfer of legislative functions from member states to the EU; a powerful European judiciary which has the last word on fundamental matters; EU responsibility for critical external relations in the economic field; a single currency. These innovations and others have already created a political union! ... Yet, citizens, political parties and national parliaments, showing remarkable schizophrenia, combine basic support for these developments (which otherwise could not have been achieved) with a sense of frustration and a lack of participation on their part, because of the resolutely national character of the political process. This fundamental contradiction ... represents a serious threat to the stability of the European political system at each of its different levels: regional, national and European. If this European political gap is left open for too long, resentment of the Union will grow. Citizens will feel strangers to it. Political leaders will lose interest in it, except when sitting at the European Council. National parliaments and regional authorities will become increasingly hostile to Brussels.’

Today these words read like a prediction and one which should have been better heard. The French and Dutch ‘no’s of 2005 and the Irish ‘no’ of 2008 have added new ballast to the criticisms of the Union’s democratic process. The democratic character of Europe’s institutions cannot be disputed, but it must be admitted that the EU has not yet made a success of its transformation from a diplomatic mode of functioning to a political one.

This is why the case stated by Notre Europe in 1998 is today more relevant than ever and must be re-made. Of course, this is not to suggest that the trans-ideological European consensus be placed in question, nor that a left-right framework be created for all European issues – nor finally that an exclusively majority culture be adopted. In all unions, the constitutional

foundation and its dynamics need to be based on loose-fitting agreements. But it would be a mistake not to recognise that the EU is having difficulty finding a popular support base and remains widely perceived as a project wanted and led by elites. Citizens' unease also derives from the fact that they continue to attribute more powers to the EU than the EU really has. We should therefore not bury our heads in the sand: the survival of the project is at stake if Europeans do not feel that they have – on European issues – an understanding of competencies, clear political choices, and personalities who embody them. The 2009 European elections are an opportunity that must not be missed.

It is true that since 1998 much has been achieved. By extending the scope of co-decision, the most recent treaties have made the European Parliament a quasi co-legislator. By the same token, the procedure arrived at in the Lisbon Treaty for designating the Commission's President stipulates that the candidate proposed by the European Council be elected by the Parliament on the basis of election results. This is one of many reasons why the ratification of the Lisbon Treaty before the European elections would be very desirable.

Whatever the institutional advances, the European elections depend mainly on the way the campaign is led. And primary responsibility lies with Europe's political families and their capacity to assemble clear electoral platforms. The emergence of pan-European political foundations and the efforts of the main parties to move in this direction must be encouraged. But we must remember and emphasise the importance of the European Steering Committee's 1998 proposal – that during the campaign each European political family present a candidate for the post of President of the European Commission and that this candidate engages in debate with his or her opponents.

Humanity is consuming resources at a rate that nature cannot sustain. Europeans, who represent 7% of the world population, use 17% of the non-renewable natural resources consumed each year. Despite the rarity of these resources, world energy demand and carbon emissions will continue to rise significantly over the next 20 years. The EU's external dependence is also set to increase. By 2030, 70% of Europe's needs are likely to be met by imports.

Confronted with this situation, the EU has proved its ability to play a leading role in the fight against climate change. It has defined common positions, defended them and demonstrated leadership in international negotiations. The Union must maintain this coherence in the coming negotiations, in order to convince the United States and the emerging economies to take a full stake in the effort to reduce emissions.

Yet unless it is able to act on its own energy consumption, the EU will not be credible. At several points the Commission has made proposals, which the member states have debated without any convincing outcome. Do we really need a more severe crisis to make clear that in this area, as in others, there will be no satisfactory solutions without thoroughgoing cooperation and specific objectives?

The creation of an effective internal energy market is a necessary step to assure consumers that demand will be met with the best possible conditions. A genuine internal market for energy would also give the Union clout in its negotiations with producer countries. However, the conditions would still need to come together to allow the Union to act, vis-à-vis both internal economic actors and external countries of energy production and transit.

The proposal to separate the transport network from energy production and distribution is not sufficient to create a single internal market. Such a market needs rules and an authority capable of ensuring that they are

correctly applied. Only a single regulator of the gas and electricity markets can guarantee that the operators will provide, in a timely manner and at the best price, the energy supplies necessary to meet demand.

At the same time, the Union must be endowed with a capacity to act in order (a) to invest in transport networks, (b) to finance research, and (c) to lead a common policy vis-à-vis producer and transit countries. On these three subjects, competition between states brings no added value; on the contrary, it is a source of waste and conflict. No country has an interest in financing, alone, the infrastructure and supply networks for energy coming from third-party countries and destined for several member states. No single member state can mobilise, in the way the United States has done, the resources needed for research which will lead to new sources of energy. The EU cannot accept that the energy supply to a member state be compromised; it must therefore ensure that solidarity can be respected by means of adequate infrastructure, and thus that no third-party country can make targeted reductions of energy supply.

In spite of the Commission's proposals, the absence of political will means that decisions made do not befit the gravity of the situation. The member states which wish to cooperate in this area should define the parameters of their cooperation by means of a special treaty.

To move forward it is also necessary to establish partnerships between the member states which are ready to pool their interests in order to bring to fruition infrastructure projects or research programmes, just as it has been done for some major industrial projects.

However, this action will not be credible if citizens are allowed to believe that they can continue to consume artificially cheap energy. Energy prices must take account of the fact that resources are rare and that energy consumption has a negative impact on the environment. They should not

be the object of competition between member states: energy is a common good, to be properly managed. The future energy treaty should therefore include dispositions to allow member states to decide by qualified majority to harmonise energy taxes and to make the tax receipts a common resource for financing energy efficiency, the development of alternative energy sources and the fight against greenhouse gas emissions. This new treaty should provide for the establishment of a High Authority for Energy.

3. Two preconditions for success

All authentic unions comprise three elements: the ‘common thing’ (the *res publica*), a capacity to make decisions on *res publica* and the means for implementing these decisions. In the current treaties, the *res publica* is proclaimed repeatedly but all too often is not put into practice for want of both a decision-making capacity and resources. An analysis of the Union’s impasse can be summed up by the simple phrase: ‘with unanimity and without budget, there is no union’.

3.1 The capacity to decide: free the EU from the straitjacket of unanimity

The idea of a union comes from a recognition by participants of their interdependence: no one of them can achieve its own objectives without cooperating with the others. This is the founding *res publica* of a union: not the permanent search for unanimity but rather the recognition of a shared interest which needs a collective action even when there is disagreement. To reconcile the common interest with a diversity of viewpoints, there is

one method and one only that has met this need: decision by majority. To take decisions in a union is to choose a single line of action, accommodating or passing over the differences of opinion on the means used. The decision can be – and often is – a compromise that fully satisfies no one but is acceptable for the majority. A union is not possible without the principle of majority. Paralysis caused by the power of veto is not a defect of union. It signifies the absence of union.

The capacity for decision – and this is the paradox of every union – exists only if members are able to decide in spite of disagreement. Unanimity means the occasional coming together of priorities, much more than it means decision.

Europe has been in an impasse for more than fifteen years. The opportunity missed in Maastricht, when it was decided to create a monetary union without a political one, stands out as clearly as ever. It is now time to break the impasse. The treaties already offer many openings for decision-making, even without explicit unanimity. In practice the theoretically ideal route of majority decision is not always the easiest. So it must be remembered that there are many ways to leave behind the myths of the veto and unanimity. One such lies at the very origin of the European project: at the Messina Conference of 1955, when the foundations of the Treaty of Rome were laid, Great Britain decided to leave the gathering, while the others opted to push on ahead. Schengen, the EMS and the euro are all examples of advances made by certain countries and followed by others later.

3.2 Resources: a budget fit for declared ambitions

A decision means nothing without the means to implement it. These means might be legislative, administrative, legal, diplomatic, military or of course financial. Without budgetary resources there is no real union – just a virtual one. A budget is much more than a collection of figures. It is the means and

the expression of policy. The time has come for a thoroughgoing discussion on the role of the EU budget and on how to bring the budget into line with its own declared objectives. There is an opportunity in 2008-09, when the Commission will re-examine the budget, following a demand of the European Council in 2005. To miss this opportunity would be inexcusable.

The major flaws of the current budget system are well known: a rigid decision-making procedure, the absence of discretionary powers in the budget-making process, the inadequacy of resources for common policies, the lack of own resources. The economic crisis should incite us to make a priority of the European budget issue. For economic analysis leaves no doubt that growth in the share of European spending relative to that at national level would (the total of national and European spending being equal) appreciably increase the efficiency of spending – just as (assuming equal results) such growth would allow resource savings. This is true for defence and for all the Treaty-mandated common policies of which the most important is probably the common agricultural policy. It is therefore untenable to argue against a more generous and flexible budget on the grounds of spending discipline or economic efficiency. The obstacle is not economic, it is political. What is necessary is political analysis and political action.

The budgetary procedure seems intergovernmental in nature and is dominated by the institution of the Council. But we must not forget that the Commission retains exclusive power of initiative and that without a favourable vote by the Parliament no budget can be approved. It is important therefore that these two institutions use their power with determination and that they are steered towards ambitious objectives. The aim should be to make the budget debate the centrepiece of the discussion on the Union's Treaty-mandated policies and a forum for fruitful political exchange – with perhaps necessary but transient conflict – between the Union's institutions.

Currently, the budgetary negotiations start with a spending ceiling and focus on the allocation of funds. This top-down logic must be replaced by a bottom-up approach which begins with a decision on political priorities. The next budget perspectives should be based on a long-term political objective and a clearer definition of European public goods.

The time has also come for a realistic transition to a system whereby the Community budget is financed by its own resources. A budget financed by national contributions does not correctly reflect the status of the Union (which the treaties define as a community of both member states and citizens) and it harms efforts to make the Union more democratic and closer to its citizens. The current system not only contradicts article 269 of the TEC (retained in the Treaty of Lisbon), which stipulates that 'Without prejudice to other revenue, the budget shall be financed wholly from own resources', it also encourages member states to focus their negotiating efforts on maximising their net balance.

The budgetary negotiations also represent a striking example of the weakness of unanimity as a decision-making method. Unanimity is utterly unsuited to a Europe of 27 members and turns budget negotiations into a game of horse-trading between states, in which the common interest is entirely neglected. A reform of the decision-making procedure has become imperative. Before becoming legally binding, this reform could be adopted and tested in practice, which would help to reassure more reluctant countries.